NO. 21810

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In the Matter of

WESTERN GROWTH CORPORATION,

Bankrupt.

STEPHEN CRANE, III,

Applicant and Appellant,

vs.

CURTIS B. DANNING, etc.,

Respondent.

CURTIS B. DANNING, etc.,

Cross-Applicant,

vs.

LOUIS BENVENISTE, et al.,

Cross-Respondents and Appellants.

OPENING BRIEF OF APPELLANTS

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

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I

INTRODUCTION

Appellants are, or derive their interest from, 15 of a total of 31 persons who in the Summer of 1959 lent $210,000 to James A. Bower and his wife. This loan was evidenced by the Bower's

execution and delivery of a promissory note in that amount and secured by a deed of trust on approximately 14-1/2 acres of real property in Escondido, California (known in these proceedings and hereafter referred to as Escondido No. 3). The Bowers were able to purchase Escondido No. 3 with part of the loan proceeds derived from the aforementioned loan.

In 1960, the other 16 of the original 31 investors assigned their undivided interests in said promissory note and deed of trust to Western Growth Corporation, the bankrupt herein, which, in the meantime, had acquired Escondido No. 3 from the Bowers, and assumed their obligation under the subject note and deed of trust.

The sole, real question presented in the two applications heard by Referee Champlin below was simply whether or not upon the sale of Escondido No. 3 appellants were entitled to be paid all of the net proceeds derived therefrom, up to the sum of $84,452.36 plus interest thereon (the amount admittedly owed to them) or whether the Trustee in Bankruptcy was entitled to dilute their interest by asserting the claims of the 16 of the original 31 investors who, as indicated above, had previously assigned their interest in the subject note and deed of trust to the bankrupt.

But Referee Champlin erroneously focused his attention upon the red herring question of whether or not a valid security in Escondido No. 3 was created by reason of the mechanics used in effectuating the original loan.

Because appellants believed that the Referee had clearly erred in this matter, by holding (1) that the deed of trust which

came out of the original loan transaction was null and void, and (2) that appellants are only entitled to share in 33/70 of the net proceeds to be derived from the sale of Escondido No. 3, they timely petitioned the United States District Court, Central District of California to review said order. And upon entry of an order by the Honorable Thurmond Clarke, Judge of said court, summarily affirming said Referee's order without opinion, appellants perfected the subject appeal.

II

BASIS OF JURISDICTION

The appeal at bar is from an order of the Honorable Thurmond Clarke entered on February 10, 1967, affirming the order of Referee Herschel Champlin of February 1, 1966, entered upon the application of Stephen Crane, III, and the cross-application of Curtis B. Danning, Trustee in Bankruptcy for the bankrupt corporation. The District Court had jurisdiction to review said order under and pursuant to 11 U.S.C. §§ 11(7) and 46, and 28 U.S.C. §1334. This Court has jurisdiction to review said district court's order pursuant to and under 11 U.S.C. §47(a).

III

STATEMENT OF THE CASE

As will appear more fully below, most of the relevant facts

in this case were either stipulated to or are not in dispute. They are as follows:

A. Facts Concerning Validity of Subject Note and Deed of Trust.

In the Summer of 1959, Alan Realty Company, a firm of real estate and loan brokers (Reporter's Transcript [hereafter R. T.] pp. 108, 187, 190, 193, 203) solicited and obtained from 31 of its clients a loan totaling $210,000 on behalf of James A. and Melba L. Bower (R. T. pp. 225-26, 238-40, 244). As was normal in these transactions, the principals of Alan Realty Company expressly represented to the 31 investors that their investment would be evidenced by a promissory note from the borrower and secured by a deed of trust on real property, which representation was a major inducement to the lenders to make their loan (R. T. pp. 225-26, 261, 238-40, 246-48, 250, 269).

The $210,000 loan proceeds were deposited by Alan Realty Company, on behalf of its 31 investor clients, into a loan escrow at the Wilshire Escrow Company (Escrow 34757) along with written escrow instruction dated August 31, 1959 executed by each of the 31 lenders (R. T. p. 29, Crane Ex. 4), providing as follows: "I hand you herewith the sum of [the applicable dollar figure] which you are authorized to deposit in this escrow and use upon the instructions of Milton N. White, Trustee." (Pretrial Conference Order, par. 7, Clerk's Transcript [hereafter C. T.] p. 95e).

Mr. White at that time was and now is an attorney duly licensed to practice law in the State of California (R. T. p. 65). At the time of the subject loan transaction, he was the attorney for Alan Realty Company and certain of its principals and had acted as such for a period of some years past (R. T. pp. 52-60, 78).

Mr. White permitted his name to be used in the loan escrow as lender and, as appears below, as beneficiary of the note and trust deed which emanate therefrom, upon the specific instructions of his client, Alan Realty Company (R. T. pp. 64-66). Indeed, he had acted as "Trustee" for Alan Realty Company before in similar loan transactions (R. T. pp. 74, 205).

Pursuant to the written instructions of each of the 31 lenders quoted above, Mr. White and the Bowers executed a 2-page loan escrow agreement also dated August 31, 1959, which is in evidence as Crane Ex. 6. These escrow instructions were signed by Mr. White as "Milton N. White, Trustee", and require Wilshire Escrow Company, as escrow, to use the $210,000 deposited in accordance with the instructions, if on or before a certain date it held a policy of title insurance on the Escondido No. 3 property, showing title vested in James A. Bower, a married man, free of encumbrances, except:

> " . . . .
>
> "Trust deed . . . to secure note for $210,000 dated August 31, 1959 . . . payable monthly, in favor of Milton N. White, Trustee, ..."

Said instructions also requested said escrow to record "any instruments delivered through this escrow, if necessary or proper in the issuance of the policy of title insurance called for . . ." (See General Instruction 6).

The promissory note dated August 31, 1959, executed and delivered by the Bowers to Wilshire Escrow Company (in evidence as Crane Ex. 1), is made payable to "Milton N. White, Trustee" and specifically states that it is secured by a deed of trust to Wilshire Escrow Company, a corporation.

The subject deed of trust, also dated August 31, 1959 (in evidence as Crane Ex. 2), is in favor of Wilshire Escrow Company, as Trustee, and "Milton N. White, Trustee", as Beneficiary, and was admittedly executed and delivered by the Bowers to the Wilshire Escrow Company (Pretrial Conference Order, pars. 3 and 4, C. T. p. 95d). The upper left-hand portion thereof, under the printed words "When recorded mail to", bears the typewritten or stamped words: "Alan Realty Company", followed by the address thereof. This deed of trust was recorded on September 8, 1959, in the Official Records of San Diego County, and thereafter, pursuant to the express direction contained therein, was mailed to Alan Realty Company (R. T. pp. 26-27).

Mr. White testified, without contradiction, that he permitted his name to be used as trustee in the subject escrow and on the subject promissory note and deed of trust solely and simply in order to act on behalf of the original 31 investors as a dry or passive trustee (R. T. pp. 217, 197, 200, 208-210). This was

done, he testified, in order to facilitate and simplify the loan transaction by using one person in behalf of and in the place of the 31 investors, which person would act on their behalf as record beneficiary under the note and trust deed until Escondido No. 3 was subdivided into individual lots. At this time, Mr. White testified, it was contemplated that individual notes secured by individual deeds of trust on said lots would be issued and be substituted for the omnibus $210,000 promissory note and deed of trust (R. T. pp. 208-210).

For more than two years after the subject escrow closed in September, 1959, until the time of default in December, 1961 (Pretrial Conference Order, par. 10, C. T. p. 95f), Alan Realty Company continued to act as agent for its 31 investors. In such capacity it retained the subject promissory note and deed of trust in its vault, it received payment from the Bowers and subsequently from the bankrupt (after it acquired the property) and it handled the accounting and depositing the moneys collected for many of the original 31 investors (R. T. pp. 193-194, 203-04, 225-26, 238-40, 106-107; Crane Ex. 2 and Crane Ex. 8).

And yet, in the face of this undisputed evidence, the Referee held that the promissory note and deed of trust were null and void!

B. Facts re Appellants' Interest in Proceeds of Sale of Escondido No. 3.

The relevant facts which go to the only real question in this case: whether or not appellants are entitled to all of the net proceeds received from the sale of Escondido No. 3 until their admitted obligation is paid off, are as follows:

On or about June 11, 1960, by written agreement (in evidence as the second Crane Ex. 3), the Bowers agreed to sell certain of their assets, including Escondido No. 3, to Messrs. Horwitz and Harris or their nominee. On or about July 1, 1960, by written escrow instructions, the bankrupt, Western Growth Corporation, was named as nominee and thereafter took title to such assets, including Escondido No. 3 (Pretrial Conference Order, par. 18, C. T. 95e; second Crane Ex. 3).

There is a factual dispute over whether or not Western Growth Corporation, the bankrupt, purchases Escondido No. 3 subject to the subject deed of trust or expressly assumed same. In spite of the Referee's finding to the contrary (C. T. p. 67, Finding No. 19) the uncontradicted evidence clearly and unequivocally demonstrates that the bankrupt expressly assumed the obligation to pay the promissory note secured by the subject deed of trust.

Thus, one of the documents in evidence forming a part of second Crane Ex. 3 is an addendum dated June 27, 1960, to the contract dated June 11, 1960, between Bower and Messrs. Horwitz and Harris, the key provision of which paragraph 14 provides as follows:

"It is understood and agreed that any responsibility on the part of the second parties [defined in the June 11, 1960 agreement to be the Bowers] to make any payments whatsoever on account of the purchase price of contracts of sale due or interest payment or amortization of principal payments or any or all of them, shall cease and terminate with respect to all personal and real property, including the 14+ acres mentioned in par. 5 of the master agreement as of June 11, 1960 [i.e. Escondido No. 3]. The first parties [Horwitz and Harris or nominee] shall accomplish same and hold second parties harmless from said payments accruing after said date." (emphasis added)

Since portions of the North County Escrow Company instructions between the original sellers of Escondido No. 3 and James A. Bower, as buyer (in evidence as second Crane Ex. 5), clearly demonstrate that the sale as consummated was an all cash sale (see short instruction dated August 28, 1959, and closing escrow statements to James A. Bower and the sellers, Mr. and Mrs. Lepman) the express reference in par. 14 of the addendum quoted above to the obligation concerning Escondido No. 3 must be to the obligation secured by the subject deed of trust. Thus, Western Growth Corporation, as nominee, was bound by the express agreement of its nominors to satisfy the Bowers' obligation under

the subject note and deed of trust. 1/

That Western Growth expressly so assumed is further evidenced by the fact that from the date of its acquisition of the property in the Spring or Summer of 1960, until it defaulted around December 31, 1961, it made all payments due on the subject note and deed of trust (Pretrial Conference Order, par. 10, C. T. p. 95f; R. T. 106). 2/

The only other relevant fact which must be considered on the question of the appropriate disposition of the proceeds derived from the sale of Escondido No. 3, is that in approximately August, 1960, 16 of the original 31 investors accepted, in return for an assignment to the bankrupt of their undivided interests in and to

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1/ Of course, it is settled in California that the construction placed upon a written instrument by the trier of fact is not binding on the reviewing court (Parsons v. Bristol Development Co., 62 Cal. 2d 861, 402 P. 2d 839 (1965)) where, as here, there is no conflict in the extrinsic evidence. This rule has been approved and applied by this Court in the recent companion cases of Bass v. Stuttman, Quittner & Treister, No. 20600 and Bass v. Gendel, Raskoff, Shapiro & Quittner, No. 20601 (reported in July 13, 1967 edition of Metropolitan News) holding that where no question of credibility involved both it and District Judge had right and responsibility to reexamine Finding and make independent judgment.

Accord: Diamond National Corp. v. Lee, 333 F. 2d 517, 523 (9th Cir. 1964); Costello v. Fazio, 256 F. 2d 903 (9th Cir. 1958).

2/ The action of the bankrupt in making such payments is itself strong additional evidence that it assumed the obligation to satisfy the note and deed of trust. See, e. g., Andre v. Stilson, 37 Cal. App. 2d 334, 99 P. 2d 557 (1940); Banta v. Rosasco, 12 Cal. App. 2d 420, 55 P. 2d 601 (1936); Dodds v. Spring, 174 Cal. 412, 163 Pac. 351 (1917); Merchants Holding Corp. v. Grey, 6 Cal. App. 2d 682, 45 P. 2d 253 (1935); Andrews v. Robertson, 177 Cal. 434, 170 Pac. 1129 (1918); Hibernia Savings & Loan Society v. Dickenson, 167 Cal. 616, 140 Pac. 265 (1914).

the subject promissory note and deed of trust, certain unsecured notes of the bankrupt (Pretrial Conference Order, par. 9, C. T. p. 95e).

IV

SPECIFICATION OF ERRORS

Appellants specify the following errors of the Court below which they rely upon herein:

A. That Judge Clarke erred in failing to reverse the order and judgment of Referee Champlin entered on February 1, 1966 (C. T. p. 177), insofar as said order adjudged in Paragraph 6 thereof that the subject promissory note and deed of trust were null and void and of no force and effect. 3/

B. That said District Judge erred in failing to reverse said order and judgment of said Referee insofar as it adjudged in Paragraph 7 thereof that a trust concerning the subject note, and deed of trust and/or the real property involved in these proceedings does not now and never has existed.

C. That said District Court erred in failing to reverse said order and judgment of said Referee insofar as it determined in Paragraph 9 thereof that appellants have an aggregate interest of only 33/70 in the subject real property as security for the total indebtedness due to them.

3/ Written objections to the proposed form of Order and Judgment were timely filed by Appellants and appear in C. T. at p. 152.

D. That said District Court erred in failing to reverse said order and judgment of said Referee insofar as it determined in Paragraph 10 thereof that 37/70 of the proceeds from the sale of the subject real property shall be paid to the Trustee in Bankruptcy herein and become part of the bankrupt estate and be free of any lien of appellants.

E. That said District Court erred in failing to reverse said order and judgment of said Referee insofar as it adjudged in Paragraph 11 thereof that said Trustee, as successor in interest to the bankrupt estate, owns all of the right, title and interest in the said promissory note and deed of trust of the 16 persons who assigned and granted said interest, as more fully set forth by said Referee in his Finding of Fact No. 20.

F. That said District Court erred insofar as it failed to reverse and reject all of the Findings of Fact and Conclusions of Law entered by the Referee in this hearing on February 1, 1966, which were objected to by appellants in their written objections filed in respect thereto (C. T. p. 146).

G. That said District Court erred in failing to overrule the rulings of said Referee insofar as said Referee overuled appellants' objections to the proposed Findings of Fact and Conclusions of Law and order proposed by the Trustee in Bankruptcy and failed to enter the alternative findings requested by appellants (C. T. 146).

H. That said District Court erred in affirming the order of the Referee of February 1, 1966, and in determining in

his order (C. T. p. 233) that said Referee's Findings of Fact were not clearly erroneous and that said Referee's order was supported by the evidence and by the applicable law.

V

ARGUMENT

A. SUMMARY OF ARGUMENT

The argument which follows is divided into two basic parts:

Firstly, the Brief will treat the question of the validity of the subject note and deed of trust and will demonstrate that:

(i) There was a valid delivery thereof; and

(ii) Milton N. White at all times acted as a dry or passive trustee for the 31 investors, including certain of appellants herein, and, as such, took title to the subject note and deed of trust on their behalf.

Secondly, the Brief will analyze the question of the correct disposition of the net proceeds derived from the future sale of Escondido No. 3, and will demonstrate that:

(i) The law is well settled that payment or release of an underlying debt, ipso facto, releases the security securing same;

(ii) Neither the debtor nor the successor in interest to the debtor's land, who pays the underlying debt or secures its release, can keep the mortgage or trust deed lien alive

and assert same against any secured creditor who has an equal or superior lien therein.

(iii) That the result described in (ii) above is the same, whether or not the subsequent owner expressly assumes the secured debt or purchases subject to said debt;

(iv) That the doctrine of equitable prevention of merger is not here applicable.

Appellants turn now to a fuller elucidation of these arguments.

B. THE SUBJECT DEED OF TRUST AND PROMISSORY NOTE ARE VALID AND IN FULL FORCE AND EFFECT.

As indicated above, Referee Champlin held that the subject promissory note and deed of trust were null and void and of no force and effect by reason of his prior determination that (i) a valid delivery thereof was lacking and (ii) no legal trust was created by designating Milton N. White as trustee thereon.

That these determinations were patently erroneous under applicable law is clearly demonstrable.

1. There Was Valid Delivery of the Subject Promissory Note and Deed of Trust.

The following principles are determinative of the question of whether or not the subject note and deed of trust were validly

delivered:

(a) It is well settled under California law that the recordation of a legal instrument at the request of the maker constitutes prima facie evidence of delivery with intent presently to convey or create the interest set forth therein. See Butler v. Butler, 188 Cal. App. 2d 228 at 233, 10 Cal. Rptr. 382 (1961) and authorities cited therein. Although this presumption of delivery is rebuttable, the burden of refutation rests on the party denying delivery. Butler v. Butler, ibid. Moreover, "recordation coupled with manual delivery raises a strong presumption, which can be overthrown only by very clear proof". 2 Witkin, Summary of California Law, Real Property, §55 and cases cited therein.

In this case, the evidence shows both the recordation of the subject deed of trust, and, pursuant to its terms, the delivery of it and the subject promissory note to the Alan Realty Company. Thus, the strong presumption of effective delivery is presented.

This strong presumption obviously has not been overcome by the Trustee in Bankruptcy. He did not even see fit to call Mr. Bower, the one man who could conceivably rebut the presumption to testify. 4/ The Trustee's only argument is that since the Alan Realty Company received a brokerage commission from the Bowers,

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4/ Bower obviously was in no position to deny effective delivery. That he thought the note and deed of trust were valid and subsisting clearly appears from the fact that he negotiated a contract with the nominors of the bankrupt corporation, requiring them to take over, satisfy and indemnify him from said obligation. (See pp. 8-10, supra).

it therefore must have acted solely as the Bowers' agent throughout this transaction and, hence, the admitted delivery of the note and trust deed to Alan Realty Company was legally insufficient. This argument is not only an obvious non sequitur, it also is clearly erroneous for a number of reasons:

Firstly, the evidence in this case clearly shows that Alan Realty Company solicited $210,000 from the original 31 lenders, who were its clients, and thereafter serviced the note and trust deed for them by receiving payments from the Bowers (and later from Western Growth), keeping the accounting regarding same and depositing for or transmitting such payments to the lenders. It thus clearly acted as agents for the 31 lenders throughout the entire transaction.

Secondly, it is a common and well-recognized practice for a broker to act as a dual agent in a sale or loan transaction. As noted in 9 Cal. Jur. 2d, Brokers, §3:

> "Usually a broker is a special agent. The chief characteristic that distinguishes him from other classes of agents is that while he is ordinarily held to be the agent of the party who first employs him, he acts as a negotiator or intermediary between both parties to a transaction. Under certain circumstances, however, he may act as the agent of both parties. Another distinguishing feature is that a broker's compensation or commission is not necessarily paid by his principal. He may secure

his fee from the person from whom he negotiates and nevertheless maintain his character as agent of the person who employs him, subject to the ordinary rules of good faith and disclosure to his principal." (Emphasis added). See also Stephens v. Ahrens, 179 Cal. 743, 178 Pac. 863 (1919).

It is therefore clear from the foregoing, that the Alan Realty Company at all times herein did act as agent for the original 31 lenders and (although it is in no way necessary to establish this agency) delivery to Alan Realty clearly constituted delivery to plaintiffs.

(b) It is clear from the subject escrow instructions (Crane Ex. 3) and the subject deed of trust (Crane Ex. 2) that White and the Bowers specifically agreed and directed that delivery of the deed of trust be made to Alan Realty Company. It is clear from the applicable cases that such an agreement, when executed, conclusively establishes the requisite delivery, whether or not at that time Alan Realty Company was acting as agent for the 31 investors. See e.g.:

City Lumber Co. v. Brown, 46 Cal. App. 603, 189 Pac. 830 (1920). ("It will not be disputed that where the grantee directs or agrees that the deed may be left for him with a third party the delivery to the latter is equivalent to a delivery to the grantee, the third party being thus constituted as grantee's agent for such purpose.");

Brereton v. Burton, 27 Cal. App. 2d 464, 81 P. 2d 238 (1938). ("It is true that a valid and binding delivery of a deed of conveyance of real property may be accomplished by handing it to a third party when it satisfactorily appears that both the grantor and the grantee intended that such delivery of the instrument would result in a present transfer of title to the grantee. (Stone v. Daily, 181 Cal. 571 (1919) [185 Pac. 665]; 9 Cal. Jur. 172, §65.)");

Handley v. Guasco, 165 Cal. App. 2d 703, 332 P. 2d 354 (1958);

Hibberd v. Smith, 1 C. U. 554;

Annotation, 74 A. L. R. 2d 992, "What constitutes acceptance of deed of grantee"; and finally

(c) Since "It is well settled that an escrow agent is the agent of both parties to" the escrow, Bonaccorso v. Kaplan, 218 Cal. App. 2d 63, at 69, 32 Cal. Rptr. 69 (1962), the Bowers admitted delivery of the subject note and deed of trust to Wilshire Escrow Company standing alone was delivery to the agent of the 31 investors, and hence in itself legally effective.

2. Milton N. White At All Times Acted As a Dry Or Passive Trustee For the 31 Investors and, As Such, Took Title to the Note and Trust Deed On Their Behalf.

Both Referee Champlin and (apparently) Judge Clarke, failed to appreciate the nature of the "trust" created by the subject transaction. The Referee looked for a trust res, a trust agreement and the other elements that one looks for when one deals with a

traditional trust. He thereby ignored the fact that what is present in the instant case is nothing more nor less than a dry or passive trust, i. e., one in which the trustee (Milton N. White) had no duties whatsoever other than to take and hold title for a time in and to the subject note and deed of trust on behalf of the 31 investors.

A discussion of this kind of trust appears in 48 Cal. Jur. 2d, Trusts, §6, as follows:

> "A 'dry' trust is one in which the trustee has no actual responsibilities and no active duties to perform. Thus, an agreement by which one party is to hold for the use of another, but under which the trustee is not assigned any duties, is not an active trust, but is a simple or dry trust. Or where the trustee is the mere depositary of the naked title, charged with no duty and without power to take possession, or manage, or exercise any control over the property, it is a dry trust. . . ."
> (Emphasis added).

And in 4 Witkin, Summary of California Law, Trusts, §17, the author states:

> "It was also clear, under CC 857, that a passive or dry trust to hold property and its proceeds, the trustees having no actual duties to perform, was void. [Citing a case].
>
> "In 1929, CC 857 and CC 847 were repealed,

and CC 2220 was amended to provide: 'A trust in relation to real and personal property, or either of them, may be created for any purpose or purposes for which a contract may be made.' Under this section, even a passive trust would be valid. [Citing a case]."

That this is a correct statement of the law appears from the following cases: Engineering etc. Corp. v. Longridge Investment Co., 153 Cal. App. 2d 404, 409, 314 P. 2d 563 (1957); Bariffi v. Longridge Development Co., 156 Cal. App. 2d 583, 590-91, 320 P. 2d 192 (1958). And see also Craven v. Dominguez Estate Co., 72 Cal. App. 713, 237 Pac. 821 (1925); Shaw Estate, 198 Cal. 352, 246 Pac. 48 (1926); Ringrose v. Gleadall, 17 Cal. App. 664, 121 Pac. 407 (1911).

Thus, Referee Champlin clearly erred in holding (as did Judge Clarke, if he affirmed same) that the subject note and deed of trust were not valid and subsisting instruments. This being the case, appellants will turn in the balance of this Brief to an analysis of real question presented: whether or not they are entitled, as they claim, to all of the net proceeds derived from the sale of Escondido No. 3 up to an amount necessary to pay off the admitted indebtedness to them.

C. THE TRUSTEE IN BANKRUPTCY IS NOT ENTITLED TO ASSERT THE CLAIMS OF THE 16 ORIGINAL INVESTORS WHO ASSIGNED THEIR INTEREST IN THE NOTE AND DEED OF TRUST TO THE BANKRUPT IN 1960.

1. Payment Or Release Of An Underlying Debt Ipso Facto Releases the Mortgage.

The law is well settled, and it is uniformly recognized, that payment of the underlying debt secured by a mortgage or deed of trust releases the mortgage or deed of trust ipso facto and nothing further need be done to cancel said debt and said security. And, of course, the payment of the obligation need not be in cash for "a release of the mortgage debt for any reason satisfactory to the mortgagee has the same effect as payment". 3 Powell on Real Property, §§ 460 and 457.

Accord: 36 Am. Jur. Mortgages, §406: ("The general rule is that payment of the mortgage debt ipso facto eo instante extinguishes the mortgage for the benefit of whoever is owner of the property at the time of payment. Indeed, on the ground that the incident cannot survive the principal, it is frequently stated that anything which operates to extinguish the debt necessarily operates to discharge the mortgage.");

4 American Law of Real Property, §§ 16.160 and 16.167 (stating that authorities unanimously hold that payment

paid the trust ceased, and the estate of the trustees ceases");

Dutton v. Warschauer, 21 Cal. 609 (1863) (holding, the character of a mortgage, as a mere security, was not changed by default in payment of the debt secured and that payment after default operated as an extinguishment of the lien equally as payment at the maturity of the debt.);

McMillan v. Richards, 9 Cal. 365 at 411-12 (1858) (holding, "the mortgage being a mere security for a debt, it must follow that payment of the debt, whether before or after default, will operate as an extinguishment of the mortgage.").

2. The Landowner Who Pays the Underlying Debt or Secures Its Release Cannot Keep the Mortgage Lien Alive.

It is equally clear that the landowner who reacquires the property free from the mortgage or deed of trust by payment or release of the underlying debt, cannot keep extant the mortgage interest which is automatically extinguished by payment.

The rule is stated in 5 Tiffany on Real Property, §1482, that, while the doctrine of merger generally turns on the intention or interest of the party in whom both interest has merged, there are certain circumstances under which neither consideration can be given effect.

"Such is the case when one who is primarily liable for the mortgage debt acquires the debt with

the lien incidental thereto, 'takes an assignment of the mortgage' as it is usually expressed. One who is primarily liable for a debt cannot acquire the debt, that is, a claim against himself and assert that the debt is still outstanding. The same person cannot be debtor and creditor, and the effect of his acquisition of the debt is to render it no longer extant. So when the person whose debt is secured by a mortgage, ordinarily the mortgagor himself, acquires the debt with its incidental lien, the debt being discharged, the mortgage lien is extinguished." (Emphasis added).

3 Pomeroy's Equity Jurisprudence, §796 (5th Ed.) states the rule as follows:

"An owner of a fee subject to a charge, who is himself the principal and primary debtor, and is liable personally and primarily for the debt secured, cannot pay off the charge, and in any manner, or by any form of transfer, keep it alive. Payment by such a person and under such circumstances necessarily amounts to a discharge. The encumbrance cannot be prevented from merging by an assignment taken directly by the owner himself or to a third person as trustee. This rule applies especially to a mortgagor who continues as the primary and principal debtor. The rule also applies to the grantee of a mortgagor

who takes the conveyance of the land subject to the mortgage, and expressly assumes and promises to pay it as part of the consideration." (Emphasis added).

Mr. Pomeroy cites numerous cases in support of the above statement of the law.

Additional cases may be found in the Annotation in 46 A. L. R. p. 322 at 329, where the rule is stated:

> "Where the owner of the fee acquires a paramount mortgage the payment of which he has theretofore assumed, equity will not keep the charge alive, whatever may be his intention or the form of the transfer of the mortgage to him."

And in 9 Thompson on Real Property, §4799, the author writes that when a mortgage debt is paid by one bound to pay it, such payment operates as a discharge and the mortgagor will not be allowed to hold it as a "subsisting encumbrance". The author further writes, in line with that rule, that:

> "A mortgagor is not allowed, after having obtained a transfer of a first mortgage made by himself, to set it up against another mortgage of later date which he has also made. . . ."
> (Emphasis added).

Accord: Coote, Mortgages (9th Ed.) 1439-1450;

Osborne on Mortgages, 861 (1951);

3 Powell, Real Property §459.

That this is the rule in California is clear from the case of Dowds v. Spring, 174 Cal. 412, 163 Pac. 351 (1917) where the court held that where the subsequent grantee of a mortgagor paid the mortgage, the payment of the debt extinguished the mortgage and prevented said grantee from taking an assignment of the mortgage to himself and thus keeping it extant.

A California case, on all fours with the instant case, is Wilson v. McLaughlin, 20 Cal. App. 2d 608, 67 P. 2d 710 (1937). There, A gave to B 6 promissory notes in the face amount of $5,000 each, secured by a single deed of trust on certain real property. Following the death of B, her estate, including the 6 notes, was distributed in equal shares to her two daughters, plaintiff and C, the wife of A. After the death of B, A conveyed to C the real property which was subject to the deed of trust. Thereafter, plaintiff brought an action to quiet her title to her 3 notes and the security. The trial court held that C's interest as beneficiary under the deed of trust merged into her title to the property and that the effect of the transaction was to extinguish the debt to the extent of $15,000, thus leaving plaintiff as the owner of 3 of the notes having an unpaid balance of $15,000 fully secured by the deed of trust. The Appellate Court affirmed in the following significant language:

"Upon their appeal the executors contend that there was no merger or partial extinguishment

of the debt, and that therefore the estate owns a one-half interest in the whole thereof. The trial court correctly held that the undivided interest of Mrs. Nelson [C] as beneficiary under the trust deed was merged in the fee title which she received from her husband [A]. This resulted by operation of law. There are many instances in which equity will intervene to prevent a merger of separate estates held in a single ownership, but they are all cases in which some right or just advantage would be lost to the owner of the two estates if the lesser were merged in the greater. [Citing numerous cases] The principle of these equitable rules has no application to the facts in evidence. . . .

"The executors point out that if no merger took place, by reason of the extinguishment of one-half of the debt, the estate would be entitled to receive one-half of the proceeds of the sale of the property under a foreclosure of the trust deed, whereas under the judgment, which declares that the estate's interest as beneficiary has been merged in the legal title to the property, the lien of the trust deed remains in full effect, and the entire property stands as security for the payment to plaintiff of the unpaid balance of $15,000. But this status, established by the judgment, is as it should be. Mrs.

Nelson obligated herself to pay the entire debt of $30,000, which means that she agreed to pay plaintiff the principle sum of $15,000, which was plaintiff's share of the notes. If the property had been sold for an insufficient amount to liquidate the debt in full, Mrs. Nelson would have been liable for the deficiency. Her obligations have not been increased by giving effect to the merger of the beneficial interest with the fee, and there is no reason why they should be diminished, if they could be diminished by a refusal to give effect to the merger." (Emphasis added)

An out-of-state case which is also on all fours with the instant case is Malinoski v. Mekody, 48 N. Y. S. 2d 940 (1944), affirmed 269 A. D. 717, 53 N. Y. S. 2d 758, the facts of which were as follows:

Malinoski, the owner of certain land, gave a $4,000 bond and mortgage to one Bucaniec covering two parcels of land containing 79 acres and 150 acres respectively. Sometime thereafter Bucaniec assigned the bond and mortgage to Bronner, who on the same day re-assigned the bond and mortgage to Bucaniec and Kuehnle. This re-assignment stated that Bucaniec's interest in the mortgage amounted to the sum of $1,200 and Kuehnle's interest to the sum of $2,800. A number of years later Malinoski, the landowner, conveyed to Mekody a portion of his farm consisting of 150 acres, Mekody assuming the payment of the mortgage

indebtedness. Shortly thereafter, Bucaniec, the assignee of $1,200 of the $4,000 mortgage indebtedness, signed an instrument releasing Malinoski from the mortgage lien and assigning to him the 79-acre parcel covered by said mortgage. Bucaniec also signed an instrument purporting to assign to Malinoski all of his rights, title and interest in the mortgage.

Thereafter, two actions were commenced:

Action No. 1 by Malinoski to foreclose the mortgage on the 150 acres of land only previously conveyed by him to Mekody and Action No. 2 by Kuehnle to foreclose the entire mortgage.

The court held as follows:

1. "[T]hat, with the assignment of the mortgage by Bronner to Bucaniec and Kuehnle, the two latter persons become the holders of coordinate participation in the mortgage debt . . .";

2. That:

"Therefore, the release to Malinoski from Bucaniec could do no more than to release the 79 acres from the lien of Bucaniec's portion of the indebtedness and could not affect the Kuehnle lien"; and

3. That:

"The total effect of these two instruments . . . was to merge the Bucaniec mortgage interest (as assigned to Malinoski) with the superior title of the latter in the 79 acres so

that then Malinoski held such parcel free from the lien of the Bucaniec $1,200 participation in the mortgage but Kuehnle still had a lien on the full 229 acres formerly owned by Malinoski as security for her portion of the indebtedness." (48 N. Y. S. 2d 946) (Emphasis added)

Thus, Malinoski also stands for the proposition that where several of a class of secured creditors are paid off or release their claim and purport to assign their individual interest in the security to the owner of the property, the debt and the security is extinguished to that extent and the remaining creditors are entitled to utilize the full net proceeds derived from the sale of the secured property until the underlying debt has been fully paid off.

Another important case is Liddle v. Lechman, 114 Colo. 189, 163 P. 2d 802 (1945). The relevant facts of that case were as follows: Plaintiff purchased certain land from the former owners thereof after the land had been conveyed to the beneficiary under a deed of trust pursuant to foreclosure proceedings. The deed given to said beneficiary as a result of said foreclosure proceedings granted to said beneficiary certain water rights. Thereafter, plaintiff paid the underlying debt secured by the deed of trust and got an assignment of the certificate of purchase from the foreclosing beneficiary. The court held that plaintiff was not entitled to assert the water rights granted to the beneficiary as a result of the foreclosure

proceeding, declaring (p. 809):

> "[W]e are convinced that the law is rather definitely established that where the payment of a lien indebtedness, in no matter what form it is evidenced, is made to the holder thereof, by parties who are personally and primarily liable therefore and whose duty it is to pay it, such a payment, no matter what form the indebtedness assumed, operates to discharge any lien. The lien becomes completely destroyed for all purposes. Under such circumstances the persons paying the lien indebtedness are not entitled to be subrogated to the rank of the holder of the lien, there is no equitable assignment to them, and even though they received a formal assignment, the lien cannot thereby be kept operative but becomes wholly merged and ended and the loan and the evidence thereof becomes absolutely extinguished." (Emphasis added)

Yet another case closely analogous to the instant situation is Bartlett v. Wade, 66 Vt. 629, 30 Atl. 4 (1894). There, the mortgagor gave a mortgage to his creditor to secure 18 promissory notes given to evidence certain indebtedness. Thereafter, four of the promissory notes were purchased by the plaintiff from the creditor. Plaintiff had the mortgagor purchase a fifth promissory note from the mortgagee, the mortgagor acquiring same under the

guise of paying off one of the mortgage notes. In an action brought to foreclose the mortgage, the court held the plaintiff was not entitled to receive out of the mortgage foreclosure proceeds payment of the fifth promissory note, holding that the acquisition by the mortgagor thereof discharged said note and released the mortgaged lien on the property to that extent.

Relevant English authorities also support the rule contended for by appellants herein:

Otter v. Vaux, 6 De. G. M. and G. 638, 69 Eng. Rep. 943 (1856);

Johnson v. Webster, 4 De. G. M. and G. 471, 43 Eng. Rep. 592 (1854).

3. The Subject Deed of Trust Was Assumed By the Bankrupt But the Result Is the Same Even If It Purchased Escondido No. 3 Subject to Said Deed of Trust.

It clearly has been demonstrated that Western Growth Corporation, the bankrupt, assumed the Bowers' obligation to pay off the subject note and deed of trust when it purchased Escondido No. 3 in 1960 (See pp. 8 - 10, supra) [5/]. But, even assuming arguendo the said purchase was made by the bankrupt "subject to"

5/ Since the subject note and deed of trust are clearly purchase money instruments, the bankrupt's assumption did not increase its exposure because in any event, under C. C. P. §580b, only the property is available to satisfy the debt. Weaver v. Bay, 216 Cal. App. 2d 559, 31 Cal. Rptr. 211 (1963); Stockton Sav. & Loan Bank v. Massanet, 18 Cal. 2d 200, 114 P. 2d 592 (1941).

the trust deed at bar, the same rule of law is applicable, for it is equally well settled that where the subject-to grantee takes an assignment of the mortgage "the debt secured by the mortgage is held to be extinguished . . ." Osborne on Mortgages, p. 700 (1951) and authorities cited at note 27 (Emphasis added).

95 A. L. R. 89, 107 ("As a general rule, where a purchaser of land subject to a mortgage takes an assignment of the mortgage, the debt secured by the mortgage is extinguished . . .");

37 Am. Jur., Mortgages, §1324 ("It is a well established rule that where a purchaser of mortgaged property who has assumed payment of the mortgage takes an assignment of the mortgage and the debt secured, the debt is extinguished and the personal liability therefor cannot be enforced. The same result has been reached in the case of a person who has purchased the land subject to the mortgage." (Emphasis added));

Goodman v. Goodman, 127 Ohio St. 223, 187 N. E. 777 (1933) (holding that an accommodation maker of a note secured by real estate was discharged from liability where one who had acquired the real estate subject to the mortgage took an assignment of the note and mortgage, the court holding that such an assignment discharged the mortgage debt since the mortgage was merged in the fee.)

The error of the Trustee's attempted distinction between a "subject to" and assuming grantee can best be demonstrated by reviewing the following hypothetical cases:

CASE 1 - Assume that A, a landowner, borrows $50 from

B and $50 from C and gives in return to evidence the debt a promissory note in the sum of $100 payable jointly to B and C secured by a mortgage on his real property also jointly in favor of B and C. Assume further that A pays B $50 and receives in return from B an "assignment" of B's interest in the note and mortgage. Assume finally that in a foreclosure action brought by C the mortgaged real property brings $50 at public sale. All of the authorities reviewed above hold or clearly indicate that C is entitled to payment in full out of the net sale proceeds of the $50 lent by him to A and that A cannot set up B's interest in the mortgage against C.

CASE 2 - Assume the facts are the same as in Case 1 with the additional fact that A sells the property to D, who specifically assumes the mortgage, D thereafter paying $50 and taking an assignment from B. Again, all of the authorities previously reviewed clearly and unequivocally stand for the proposition that C is entitled to a payment in full of the moneys lent by him to A, from the net proceeds derived from the sale of the mortgaged property.

CASE 3 - Case 3 is identical to Case 2, except D, rather than assuming the mortgage, takes the mortgage property subject to the mortgage. The Trustee has cited no authority whatsoever which would support a different holding in Case 3 from the holdings required in Cases 1 and 2 and both reason, justice and the authorities reviewed above require the same disposition in Case 3 as in the first two cases.

In all three cases the present landowner of the property

has freed the property from a portion of the lien by paying off the indebtedness to B and yet seeks to keep that portion extant in order to dilute the interests of C, one of the original lenders, upon C's foreclosure of the remaining portion of the lien.

Under the facts of our three hypothetical cases (assuming a purchase dollar situation), the landowner, if he prevails, is out-of-pocket only $25, the $50 (paid to B) less recoupment of the $25 (one-half of the net proceeds of foreclosure sale) while the surviving lender, C, has recovered only $25 of the $50 he has lent. But as shown above, in Cases 1 and 2 the law requires that the surviving lender be made whole: Reason, equity and precedent likewise require that the same result be reached in Case 3. Therefore, even assuming that which is not a fact: that the bankrupt herein purchased Escondido No. 3 subject to the deed of trust at bar, it still is not entitled to assert, as Referee Champlin held, and Judge Clarke affirmed, a claim to 37/70 of the net proceeds derived from a sale of Escondido No. 3.

4. The Equitable Prevention-of-Merger Doctrine Is Not Here Applicable.

The Trustee contended below that the rule that a court of equity can prevent a merger is applicable herein. This rule, however, has never been made available, except in this case, to permit a landowner to dilute another's security. In the past it has only been used in behalf of a senior lienor to prevent a junior or subsequent lienor from taking advantage of and reaping a windfall

from the senior encumbrancer when he acquires the mortgaged land from the landowner.

Thus, Osborne on Mortgages states:

> "It hardly needs to be stated that the preservation of the mortgage is solely for foreclosure purposes and, even for that purpose, only as to the intervening liens or other interests." (Emphasis added) Osborne, Mortgages, p. 773, n. 39, see also p. 774;

See also the similar statement found in 5 Tiffany on Real Property, §1482, quoted supra pp. 23-24.

33 Cal. Jur. 2d Mortgages, §§ 284-286;

37 Am. Jur. Mortgages, §1190, et seq.

The distinction between the use of the equitable rule of non-merger to prevent subordinate lienors from gaining a windfall and the instant case is well illustrated in the following quote from 1 Witkin, Summary of California Law, pp. 735-36:

> "A mortgage may also be discharged by merger. Suppose A mortgages to B, then sells to B. B now has the entire legal and equitable interest in the property, and ordinarily the lien of the mortgage will be merged with the title. (Anglo etc. Bank v. Field (1908) 154 Cal. 513, 98 P. 267; Jenson v. Burton (1931) 117 C. A. 66, 3 P. 2d 324; cf. Mortgage Guarantee Co. v. Lee (1943) 61 C. A. 2d

367, 143 P. 2d 98 [no merger unless entire legal and equitable estate in one person].)

"If this rule were invariable it would sometimes result in injustice to the mortgagee. Thus, suppose A, after giving the mortgage to B, gives a second mortgage to C, and then sells to B. If B's lien is merged in this title, C becomes the first mortgagee, and B must pay his claim before satisfying his own prior lien. If the value of the land is less than the amount of both liens, B will suffer a loss. Because of this possibility, it will be presumed that the mortgagee intends to keep his mortgage alive after sale, even after the instrument has been cancelled; and equity will prevent a merger when this is necessary to protect the interests of the mortgagee. (Sheldon v. La Brea etc. Co. (1932) 216 C. 686, 15 P. 2d 1098.) Thus, in Hines v. Ward (1898) 121 C. 115, 53 P. 427, an insolvent mortgagor deeded the property to the mortgagee in satisfaction of the mortgage. The mortgagor represented that there was no other lien, and the mortgagee consented to cancellation of the instrument. There was, in fact, a judgment lien of a third party. Held, the discharged mortgage would be kept alive in equity and made prior to the intervening lien. (See generally 95 A. L. R. 628; 148 A. L. R. 816.)" (Emphasis in part added).

Witkin then reviews the landmark California case of Wilson v. McLaughlin, digested supra, p. 26 and concludes that merger was proper in that case since "there were no equitable circumstances to prevent merger . . .".

Likewise readily distinguishable are the cases relied upon by the Trustee since they fall within the equitable prevention of merger category.

Thus, in Matzen v. Schaeffer, 65 Cal. 81, 3 Pac. 92 (1884), all the court holds is that a purchaser of land subject to a mortgage who pays off that mortgage as part of the purchase price is entitled to assert that mortgage against the purchaser of the property at an execution sale based upon a judgment entered after the date of the execution of the original mortgage for otherwise the purchaser at the judgment sale would be given a superior position against the person who paid off the senior lien. It is important to note that in Matzen, the court specifically states "there is no equitable ground on which the [judgment sale purchaser] could object to the mortgage lien being kept alive for the protection of [the purchaser of the property who paid off the mortgage indebtedness] interest . . ." (p. 83). Just the opposite, of course, is true in the instant case where the effect of the Trustee's argument that merger did not occur would be to dilute the security interest of appellants by more than 50%.

Also, readily distinguishable is Jameson v. Hayward, 106 Cal. 682, 39 Pac. 1078 (1895) where the court simply holds that one tenant in common of an estate for years who had acquired the

reversionary interest therein is not barred by the doctrine of merger from asserting his tenancy in common position in a partition action.

Thus, it is clear from all the authorities that the relief-from-merger doctrine has no application whatsoever where, as in the instant case, the landowner satisfies a portion of a mortgage obligation and then attempts to keep that obligation alive to dilute or defeat the remaining portions of that mortgage interest.

VI

CONCLUSION

That the Trustee in the instant case sought and received from Referee Champlin and Judge Clarke a windfall for all those unsecured creditors of Western Growth Corporation who had nothing whatsoever to do with Escondido No. 3, is clear. For the effect of the order below will be to take from the appellants more than one-half of the net proceeds from the sale of Escondido No. 3 which are the only source from which their indebtedness can be paid and give this money to the general unsecured creditors. But as a result of the swap by 16 of the original 31 secured creditors, the secured obligation of the bankrupt in respect to the subject note and deed of trust has already been reduced more than half. 6/

6/ That such a happening is of real value to the bankrupt is easily demonstrable by the following hypothetical:

Assume that the outstanding indebtedness secured by the (continued)

Consequently, now any excess of net sale proceeds from Escondido No. 3 over and above the $84,000 some odd dollars plus interest necessary to pay off cross-respondents will go to the unsecured creditors, whereas before the swap there would be nothing left for the unsecured creditors, unless the secured property produced net proceeds equal to the $210,000 less the amounts paid on the subject trust deed before the swap. Thus, the unsecured creditors already have gotten their benefit from the swap for, any excess over $84,000 plus interest will be distributed to them pro rata. To permit such unsecured creditors in addition to share in more than one-half of the net proceeds derived from the sale of Escondido No. 3 is to award them with an unfair and illegal windfall, not countenanced by any authority.

We ask this Court to so hold.

Respectfully submitted,

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By: RICHARD H. FLOUM
Attorneys for Appellants.

6/ (continued) existing loan was $200,000, and that the 16 assignors assigned their claim against the bankrupt or Bower, as the case may be, in an amount of $100,000. The bankrupt was then in a position to secure substantial additional moneys if it sought to borrow against Escondido No. 3 by reason of the fact that it was now encumbered by a lien securing an outstanding indebtedness of less than half of the original indebtedness. Surely, the bankrupt having obtained this important economic advantage, should not be permitted at the same time to assert that it can dilute the remaining creditors' lien by keeping extant its own or Bowers' indebtedness! It is of more than passing interest to note, that by a similar device the bankrupt was able to free as of March 1, 1961, approximately $500,000 worth of secured collateral notes (R. T. 116-117).

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Richard H. Floum

RICHARD H. FLOUM

APPENDIX "A"

Exhibits	Identified	In Evidence
Crane Ex. 1 (Promissory Note)	24	Received p. 25
Crane Ex. 2 (Trust Deed)	26	Received p. 26
Crane Ex. 3 (Bower-White Escrow Instructions)	28	Received p. 28
Crane Ex. 4 (Short Form Escrow Instructions)	28	Received p. 29
Crane Ex. 5 (Judgment by Court After Default)	30	Received p. 30
Crane Ex. 6 (Application of Trustee to Sell)	31	Rejected p. 32
Crane Ex. 7 (Second Application of Trustee)	33	Rejected p. 34
Crane Ex. 8 (February 5, 1962 letter)	34	Received p. 35
Trustee's Ex. A	43	Received p. 43
Trustee's Ex. B	43	Received p. 43
Trustee's Ex. C	43	Received p. 43
Trustee's Ex. D (Letter)	43	Rejected p. 49
2d Crane Ex. 1 (Alan Realty Co. Accounting)	226-27	Received p. 227
2d Crane Ex. 2 (August 13, 1959 letter)	246	Received p. 247
2d Crane Ex. 3 (Bower Sale Documents)	278	Received p. 280
2d Crane Ex. 4 (Settlement Agreements 10/21/66)	281	Received p. 281
2d Crane Ex. 5 (Bower Purchase Escrow Documents)	281	Received p. 282
2d Trustee's Ex. A (Claim for Taxes)	287	Received p. 287